



December 31, 2002
E-120-900



Mr. Tom Carter
Power Operations Manager
Western Area Power Administration
Sierra Nevada Customer Services Region
114 Parkshore Drive
Folsom, CA 95630-4710

Dear Mr. Carter:

Redding Electric Utility (REU) respectfully submits the following written comments on the Western Area Power Administration's (Western) Notice of Proposed Decision on Operational Alternatives for the Post-2004 Operations. As noted in our August 8, 2003, comments submitted to Western in this process, REU has invested millions of dollars to be directly connected to Western's generation and transmission grid. Further, as a Western preference customer as well as a Western transmission customer, REU has a substantial and direct interest in the outcome of this decision process. The major points that our comments will address are:

REU believes that:

- Western has appropriately removed the No Action and Participating Transmission Owner (PTO) Alternatives from any further consideration;
- The Metered Sub-System (MSS) Alternative does not "Almost Meets" the evaluation criteria and should also be removed from any further consideration; and
- No compelling argument has been presented for Western to not directly continue the pursuit of the Control Area Alternative.

In the alternative to forming a Western-based control area, REU believes that:

- Western should continue to become control area capable on a parallel path with any negotiations;
- The "sub-control area" contract-based approach must be timely and meet certain criteria; and
- Either the control area or the "sub-control area" must address the inclusion of the California-Oregon Transmission Project (COTP) facilities.

Western's Federal Register Notice (FRN) Evaluation Process

In Western's evaluation process, as fully discussed in the FRN, Western completed a matrix review of the various alternatives using the five stated evaluation factors. Western's evaluation was based upon general information provided to Western and an interpretation of the tariff that exists today, with some consideration of the proposed tariff upcoming tariff changes. REU agrees with Western that the No Action and PTO Alternatives clearly do not meet the evaluation criteria. However, REU believes that Western's evaluation approach, with regard to the MSS Alternative does not fully capture

the dramatic changes that the California Independent System Operator (California ISO) has proposed to make to its entire operations based upon its recent Market Design 2002 (MD02) filings with the Federal Energy Regulatory Commission. As one example, the California ISO's MD02 filing¹ erodes existing transmission contracts by removing the ability to utilize those contract rights to schedule transmission in the real-time market. While the California ISO's MD02 filing is not effective today, Western must consider the implications of the MD02 changes on Western's overall operations.

REU has concluded that many of the "features" of the California ISO's proposed MD02 system, such as Locational Marginal Pricing (LMP) and Congestion Revenue Rights (CRRs), are not at all compatible with Western's obligations to serve Project Use, first preference and preference customers under the 2004 marketing plan. Worse than the California ISO's LMP/CRR scheme is the lack of clarity regarding the alleged transmission congestion remedy that is to magically appear from the implementation of LMP and CRRs. The California ISO cannot explain how CRRs will be allocated. They cannot explain how LMP and CRRs will protect customers from onerous congestion charges. They cannot explain how LMP and CRRs will address the unique characteristics of hydro generation. They cannot explain the duration of CRRs when distributed. It is obvious from the California ISO's statements to date that firm transmission rights at predictable costs will be an artifact of history. Redding does not believe this type of uncertainty is beneficial to Western's customers and will jeopardize Western's ability to honor its contractual obligations to REU for transmission service. The financial consequences which may arise from the elimination of firm transmission rights within any alternative chosen by Western must be taken into account or somehow mitigated.

Additionally, many aspects of the California ISO's existing tariff as well as the proposed tariff changes conflict with Western's statutory obligations. For example:

Under the Supremacy Clause, Property Clause, and the Property Management laws, a federal agency must have the ultimate control over its property. Thus, Western and the U. S. Bureau of Reclamation (Reclamation) must retain full operational and financial control of their generation and transmission facilities.

Federal agencies are unable to agree to be sued without a specific waiver of sovereign immunity by Congress. Many portions of the California ISO's tariff, where charges associated with the failure of other California ISO's participants are allocated to the remaining participants, could not apply to Western.

The California ISO's concepts of sanctions and generation/transmission control conflict with the doctrine of sovereign immunity and the Supremacy Clause of the Constitution. Without specific authority, a federal agency may not allow a state, municipality, or individual to exercise control over the agency's actions. The California ISO's generation control agreements or the MSS equivalent would violate the government's sovereign immunity.

¹ July 22, 2003, Amendment to its Comprehensive Market Design Proposal (MD02). The California ISO's July 22 Amendment modifies its May 1, 2002, MD02 proposal to incorporate modifications to certain market design elements. Docket Nos. ER02-1656-015 and EL01-68-028.

Federal appropriations' law conflicts with numerous provisions of the California ISO's tariff and precludes federal entities from participating in the California ISO. Federal laws prohibit officers of the United States from committing funds prior to a Congressional appropriation. Current provisions of the California ISO's tariff would obligate federal entities to commit funds prior to Congressional appropriation thus violating the Anti-Deficiency Act.

The Administrative Procedure Act (APA) under Reclamation law governs Western's rate-making process. Many, if not all of the California ISO's markets, like LMP, would be in direct conflict with Western's rate making process. Further, under the APA, Western cannot consent to any form of California ISO-based Alternative Dispute Resolution process.

Under Reclamation laws, Western has the duty to deliver power, generated by project power plants, to project and preference loads. Thus, Western cannot transfer operational control to the California ISO of its federal transmission lines that are used to serve these loads.

As a part of federal legislation, Western received approximately 100 megawatts of entitlement to the COTP on behalf of the Department of Energy's labs and the federal wildlife refuges in California. Such firm transmission access must be protected by Western.

Western remains a party to numerous Existing Contracts that provide certainty of service that must continue to be honored for the duration of the contracts, without pressures to change from the California ISO's tariff. The California ISO cannot use its tariff to abrogate the benefits of Existing Contracts. Western's existing preference power sales contracts extend for an additional 20 years and must be honored.

Within the backdrop of Western's statutory obligations, REU cannot support Western's evaluation summary conclusions for the MSS Alternative. Also, as was acknowledged in the FRN, Western has not included any of the additional operating costs that will be imposed by the California ISO on Western's customers, like REU. Further, REU believes that the MSS Alternative will force other California ISO protocols on Western's customers with totally unacceptable consequences. One prime example was the California ISO imposing rolling blackouts on all Scheduling Coordinators, when the emergencies were clearly caused by generation shortages within other Load Serving Entities' service areas. Thus, REU would recommend that the MSS Alternative clearly cannot meet the evaluation criteria and should be removed from any further consideration.

The Control Area Alternative

Over the years, REU has strongly supported the formation of a Western control area in northern California. The formation of a Western-based control area would provide Western with the optimum ability to meet its statutory obligations and control costs for its preference customers. Further, upon reading public comment record and the FRN issued December 2, 2003, it would appear that the best option for Western continues to be the Control Area Alternative.

To briefly summarize the key points to date:

1. Western's customers strongly supported the development of a Western-based control area as stated during the public comment period.
2. Western's customers have contributed over \$19 million in fiscal years 2002-2004 for Western to prepare for the Post-2004 Marketing Plan and become control area capable.
3. Western's cost/benefit analysis concluded that the formation of a Western-based control area was the most cost effective alternative.
4. Western's FRN Evaluation Summary concluded that the Control Area Alternative was the only alternative examined that met all of the five evaluation criteria.
5. The formation of a Western-based control area best protects Western's statutory obligations to serve Project Use and preference customers.

Additionally, at the request of the California ISO, the Western Electric Coordinating Council (WECC) has recently reviewed its control area certification procedures with specific regard to the formation of a Western-based control area. REU participated first hand in support of Western at the WECC meetings regarding this issue. WECC as the proper authority has concluded that **NO** moratorium should be placed on the certification of new control areas and that the existing certification procedures are sufficient, thus debunking the "red herring" reliability arguments raised by the California ISO.

Based on the record to date, one could easily conclude that Western should be on a fast track to developing the Control Area Alternative. Further, the formation of a Western-based control area would fully comply with all of Western's aforementioned statutory obligations. REU is in full support of the Control Area Alternative. Therefore, we see no compelling evidence in the record for Western's decision to NOT form a Western-based control area at this time. Any decision by Western to pursue other alternatives that are based on non-economic factors, that inflict economic burdens on Western's customers, like Redding, must explicitly consider the costs of mitigation. In the case of Redding, the implications of the California ISO's market changes as previously noted, could significantly devalue Redding's local generation and its out-of-state, long-term, forward-market purchases. The impacts to Redding alone have been estimated to easily exceed several million dollars per year.

Other Operational Control Area Alternatives

However, two other options were noted in the FRN. The options were that Western may consider the benefits of integrating as a "sub-control area" within another control area, like the Sacramento Municipal Utility District (SMUD) or the California ISO. As previously stated in our written comments, REU could live with such a "sub-control area" alternative if done right. In the FRN, Western notes that the "Other Operational Alternatives" were not similarly evaluated due to a lack of sufficient detail. Therein lies REU's principal concern with the "sub-control area" option. As often quoted in the power industry, "The devil is in the details." Whereas the control area criteria are explicitly outlined by the

WECC and can be analytically as well as technically evaluated by all involved, the "sub-control area" approach chosen by Western is somewhat uncharted and vaguely defined. To that end, while understanding and willing to support Western's negotiation approach with SMUD and the California ISO, REU would like to take this opportunity to focus our comments toward helping Western define the structure of an acceptable "sub-control area" and an action time line.

1. Customer Support

Western should move immediately to create a customer support committee that can be used as a resource during proposed negotiations to form a contract-based sub-control area with either the California ISO or SMUD. (As previously stated, REU has a vested interest in the outcome of these negotiations.)

2. Western-based Control Area

As Western begins negotiations on behalf of a contract-based sub-control area agreement with either the California ISO or SMUD, it must state in clear and unambiguous terms its intent to continue its effort toward creation of a Western-based control area. The outcome of negotiations with the California ISO and SMUD is uncertain – and the time line for a post-2004 operational plan is very short. Western must move forward with its own control area in the event that contract-based sub-control area negotiations are unable to meet the needs of the Sierra Nevada Region's federal power system post-2004. Toward that end, work to establish a Western-based control area, including filing for WECC certification, should continue in parallel with the negotiations.

3. WECC Filing

Western should aim to submit its Western-based control area filing to the WECC on February 1, 2004. This allows for the ongoing 30-day FRN comment period to conclude, and as well, would provide an additional 30 days to pursue and gauge potential success of Western negotiations with the California ISO and SMUD with regard to sub-control area formation.

4. Negotiations

A clear and aggressive schedule for sub-control area negotiations with the California ISO and SMUD must be established by Western. Given the time constraints Western faces in addressing post-2004 operational issues, the agency must conduct negotiations expeditiously, and ensure that a lengthy negotiating process with uncertain outcomes does not have the effect of foreclosing potential implementation of other beneficial operational alternatives.

5. Measurements of Success

Western needs to establish clear and definitive elements for measuring the success of the sub-control area negotiation process. There must be grounds for agreement in the following areas for contract-based sub-control area to succeed:

WECC Certification: The contract must be with a WECC certified Control Area Operator. It must provide for a six-month "off ramp," and expressly honor Western's existing contracts. By its terms, the contract must state that it is not subject to unilateral change by the Control Area Operator nor the entities that regulate it.

Resource Adequacy: Assure that all parties within the sub-control area have provided for sufficient resources available to meet load obligations plus a prudent planning reserve.

Physical Transmission Rights: Western must retain firm physical transmission rights to meet preference obligations and manage, use, provide, and sell its excess transmission consistent with Open Access Same-Time Information Systems' (OASIS) principles. Such physical firm transmission rights are necessary to assure the delivery of remote resources to load under a variety of conditions. Resource adequacy has an intrinsic interdependence on the ability to reliably schedule and deliver remote resources to load. Otherwise load can only be reliably supported through local resources that severely limits the sub-control area participants from developing a cost-effective and diverse resource portfolio.

Scheduling: Western must retain rights to physically schedule resources to load and self-provide ancillary services per WECC standards, and to provide such services to its customers in accordance with federal law and the Post-2004 Marketing Plan. The ability to make close to real-time and real-time scheduling changes in order to match resources with the dynamics of load changes provides customers with the much needed tools to optimize resources and serve loads in a cost-effective and reliable manner. Overall burdens on the control area operator are significantly reduced when each utility's resource flexibility is properly allowed to be applied to its load.

Reserves/Settlements/Scheduling: Western must assure that the control area has a process for securing sufficient operating reserves. In order to limit settlement risk, billing procedures need to be timely, accurate, and completed within a month of the transaction. Scheduling protocols that balance loads to resources should be consistent with prevailing business practices in the overall WECC region.

Control Area Uplift: Western must ensure that its costs for operating the sub-control area are reasonable, stable, predictable, and allocated in a manner consistent with cost-causation principles.

COTP: Western's agreement must allow for the COTP to be operated and utilized within the sub-control area in a stable and cost-effective manner. Western should include the recognition of the need for a single path operator for the overall coordination of the California-Oregon Intertie.

Emergency Procedures: Western must ensure that the control area utilizes proper emergency management procedures. When Western's customers have made significant investments to assure resource adequacy within their respective service areas, such prudent planning must be rewarded with reliable service. Forced

rolling blackouts on all parties due to poor planning by one party are totally unacceptable. Any party with insufficient resources should bear the entire burden of any load reductions. Resource reserve sharing procedures should be established for legitimate emergencies with all parties within the control area.

Transparency: Western must ensure that the control area advisory process is transparent, balanced, inclusive, and representative of the entities involved in Western's sub-control area.

Durability: Generation and transmission projects are capital intensive ventures with a useful service life of 30-50 years. The contractual operating environment for such investments needs to be durable (30-50 years) such that investors are comfortable with the ability of the borrower to repay the indebtedness.

6. Schedule

The negotiations with SMUD and California ISO should be conducted simultaneously. The following schedule should apply to Western's activities in this regard:


Initial Negotiations: By January 24, 2004, Western should assess which negotiations have best advanced the established criteria and, in the event such progress can be demonstrated, be prepared to sign a letter of commitment with that party by February 29, 2004.

Comprehensive Agreement: Execution of a comprehensive sub-control area agreement by April 1, 2004.

Implementation: Implementation (ability to be running in parallel) by August 1, 2004. Western must hold firm to this date, as five months will clearly be needed to conduct adequate testing of this new arrangement.

Given the critical importance of this process for the City of Redding, we would strongly prefer that Western pursue the federal control area or at a minimum become control area capable as a part of any bilateral negotiations of a sub-control area approach. Please keep us apprised on the progress of any negotiations and thank you for the opportunity to provide comments to this important process.

Sincerely,



James C. Feider
Electric Utility Director